United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-7435

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ORIGINAL

APPEAL DOCKET NO. 76-7435

WARNER-JENKINSON COMPANY,
Plaintiff-Appellant,

against

ALLIED CHEMICAL CORPORATION,
Defendant-Appellee,

and

H. KOHNSTAMM & COMPANY, INC.,
Plaintiff-Intervenor-Appellant,

against

ALLIED CHEMICAL CORPORATION,
Defendant-Appellee.

Appeal from an Order and Judgment of the United States District Court for the Southern District of New York

BRIEF FOR PLAINTIFFS-APPELLANTS

Dated: October 22, 1976
At: New York, New York

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H. KOHNSTAMM & COMPANY, INC.,
Plaintiff-Intervenor-Appellant,

against

ALLIED CHEMICAL CORPORATION,
Defendant-Appellee.

BRIEF FOR PLAINTIFFS-APPELLANTS

I. PRELIMINARY STATEMENT

This is an appeal under 28 U.S.C. §1291 from the final Order and Judgment of the Honorable Marvin E. Frankel, United States District Judge for the Southern District of New York. The final Order and Judgment was entered on August 13, 1976 [Appendix at 240, hereinafter A-240] and was based upon Judge Frankel's decision at a hearing held on August 11, 1976. [A-279] Neither the District Court's decision as set forth in the hearing transcript, nor the final Order and Judgment have been reported in any publication.

II. STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

A. As a matter of law, can a case of actual controversy exist between a patent licensee and his licensor over the validity and enforceability of the licensed patents before termination of the license agreement?

B. Is deposit of royalties into escrow, *pendente lite*, proper in this case?

C. Does the District Court have the jurisdictional power to order payment of royalties after dismissing the Complaint for lack of subject matter jurisdiction?

III. STATEMENT OF THE CASE

This declaratory judgment action was commenced on June 22, 1976 by appellants, (plaintiffs below), Warner-Jenkinson Company (hereinafter "Warner-Jenkinson") and H. Kohnstamm & Com-

pany, Inc. (hereinafter "Kohnstamm"), patent licensees, against appellee, (defendant below), Allied Chemical Corporation (hereinafter "Allied"), patent licensor, seeking a judgment, inter alia, that:

(1) Allied's Patent Nos. 3,519,617 and 3,640,733 are invalid, unenforceable and not infringed by Warner-Jenkinson and Kohnstamm.

(2) Allied unfairly competed with Warner-Jenkinson and Kohnstamm. [A-4]

Concurrently with the filing of their Complaint, Warner-Jenkinson and Kohnstamm sought and obtained an order for Allied to show cause on June 25, 1976 why their proposed order approving proposed escrow agreements, authorizing deposit of royalties into escrow, and approving such deposits pendente lite as satisfying royalty payment obligations under their license agreements, should not be entered. [A-307] The hearing on the application for the proposed order was reset for August 11, 1976, but pending decision thereon, the District Court signed an Order on June 30, 1976 permitting Warner-Jenkinson and Kohnstamm to withhold their June 30, 1976 royalty payments without prejudice to their rights as licensees. [A-32]

Allied then moved under Rule 12(b)(1) Fed.R.Civ.P. for an order dismissing the Complaint on the ground, inter alia, that the Court lacked subject matter jurisdiction because of the ab-

sence of a case of actual controversy.* [A-324] A hearing on this motion was also set for August 11, 1976. [A-32]

At the hearing, the District Court, relying upon Thiokol Chemical Corp. v. Burlington Industries, Inc. ("Thiokol I"), 313 F.Supp. 253 (D.Del. 1970), aff'd, ("Thiokol III"), 448 F.2d 1328 (3d Cir. 1971), cert. denied, 404 U.S. 1019 (1972), held that Warner-Jenkinson and Kohnstamm must terminate their license agreements before bringing suit because there could be no controversy while the license agreements were in effect. The Court interpreted the license agreements as precluding termination before March, 1977 and held, as a matter of law, that a controversy could not exist between the parties prior to that date.** Thereupon, the Court granted Allied's motion to dismiss the Complaint under Rule 12(b)(1) Fed.R.Civ.P. [A-279,240] The Court never reached the issues of "controversy in fact" and "federal controversy".

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* The Allied motion presented three issues:

(1) There can be no subject matter jurisdiction in law because the license agreements were not terminated.

(2) If there can be subject matter jurisdiction in law, there is no controversy in fact.

(3) If there is a controversy in fact, it is not a federal controversy giving rise to federal declaratory judgment jurisdiction. [A-112]

** It is also submitted that the District Court erred in interpreting the agreements on this motion without taking evidence. [A-279]

At the same time the District Court denied the escrow motion of Warner-Jenkinson and Kohnstamm in view of its holding that it lacked subject matter jurisdiction. [A-279,240]

At the request of Allied, and notwithstanding Warner-Jenkinson and Kohnstamm's argument that the District Court lacked jurisdictional power to do so in view of the dismissal for lack of subject matter jurisdiction, the Court also ordered Warner-Jenkinson and Kohnstamm, within fifteen (15) days of the entry of the Order, to pay royalties to Allied which were due June 30, 1976, plus 6% interest. [A-240]

Warner-Jenkinson and Kohnstamm obtained the approval of the District Court to file supersedeas bonds in lieu of making the June 30, 1976 royalty payment and deposited with the Clerk of the United States District Court for the Southern District of New York, United States Government Treasury Bills as security for the bonds. [A-257] Immediately after so doing the instant appeal was filed. [A-255]

IV. STATEMENT OF THE FACTS

In 1971 the Food and Drug Administration (hereinafter "F.D.A.") led the food industry to believe that it would delist F.D. & C. Red No. 2* as of December 31st. [A-188,193] F.D. & C.

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* F.D. & C. (Food, Drug & Cosmetic) colors are authorized for use in foods, drugs and cosmetics by the F.D.A. [A-4,6] Red is the single most important color to the food industry. [A-4,7]

Red No. 40 was the only practicable alternative to F.D. & C. Red No. 2, [A-4,9] and Allied represented itself to the industry as the owner of a patent which covered F.D. & C. Red No. 40. [A-4, 7-8] Warner-Jenkinson and Kohnstamm sought manufacturing licenses from Allied under its patent, but Allied refused, leaving them face-to-face with potential economic strangulation. [A-39,60]

In early 1972 while the F.D.A. was still reviewing F.D. & C. Red. No. 2, Warner-Jenkinson and Kohnstamm commenced declaratory judgment actions against Allied seeking declarations of invalidity, non-infringement and unenforceability of the Allied patents.* [A-39,56-57]

Concurrently with the beginning of the consolidated trial of those actions in March, 1975, discussions among the parties aimed at concluding the litigation were instituted at the urging of the District Court. Allied first sought a consent judgment with respect to the validity, enforceability and infringement of its patents, but Warner-Jenkinson and Kohnstamm refused to agree and Allied thereupon accepted a stipulated dismissal without prejudice of the declaratory judgment patent

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* The Allied patents in suit were issued on July 7, 1970 and February 8, 1972.

ctions.* [A-39, 41-42] The parties also entered into manufacturing license agreements which contained two-year non-termination clauses. [A-39,81,94]

The terms under which the actions were concluded reflected the limited value of F.D. & C. Red No. 40 in 1975 to the businesses of Warner-Jenkinson and Kohnstamm. At that time F.D. & C. Red No. 40 was a specialty color of limited application and sales potential in view of the then continued listing of F.D. & C. Red No. 2 which was the most widely used red color additive for general use. Reflecting these commercial circumstances and in order to avoid further litigation costs, Warner-Jenkinson and Kohnstamm accepted manufacturing license agreements containing the exorbitant royalty rate of 17-1/2% of the net sales price received by them for licensed products sold. [A-4,9] However, their right to reinstitute the litigation at a later date as licensees--without prior termination of the license agreements--was expressly preserved by the dismissal without prejudice. [A-39, 69-70]

In early 1976 the F.D.A. delisted F.D. & C. Red No. 2. F.D. & C. Red No. 40 then became the <u>sole</u> commercially practicable red color additive suitable for general use in foods, drugs and cosmetics in the United States. No reasonably interchange-

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* The parties knew precisely the legal effect of their stipulated dismissals. The patent causes of action were dismissed without prejudice, but the unfair competition claims were dismissed with prejudice. [A-39,69-70]

able and federally approved substitute for this product yet exists. The 17-1/2% royalty rate therefore became economically oppressive and the incentive to challenge the validity of the licensed patents materialized once again. [A-4,9] Attempts to renegotiate the high royalty rates ended in failure and Warner-Jenkinson and Kohnstamm's only choice was to exercise their right to bring this action to invalidate the Allied patents and prevent their enforcement. [A-307,322]

At the present time Warner-Jenkinson and Kohnstamm do not intend to terminate their agreements with Allied. They are prepared to deposit royalties into an escrow fund pendente lite while establishing the invalidity of the licensed patents. However, if they find themselves in a position where they must pay royalties to Allied in order to protect their position as licensees and at the same time support patent litigation, they will be forced to reconsider the advisability of proceeding with this litigation. [A-4,8] Furthermore, Allied has stated that it would sue Warner-Jenkinson and Kohnstamm for infringement if they were to terminate their license agreements and continue to make F.D. & C. Red No. 40. [A-279,286]

V. ARGUMENT

A. Summary

Briefly, Warner-Jenkinson and Kohnstamm contend that:

(1) Lear, Inc. v. Adkins, 395 U.S. 653 (1969), and the cases following permit patent

licensees to challenge the validity of licensed patents without first terminating the license agreements.

(2) A justiciable controversy can exist between a patent licensee and licensor while the license agreement is in effect.

(3) A stipulation and order of dismissal without prejudice has no res judicata effect.

(4) Deposit of royalties, pendente lite, into an escrow fund which is under the control of the Court, is the proper and equitable procedure which will preserve the status quo in accordance with federal policy and avoid irreparable injury to the licensees.

(5) Once a court holds that it lacks subject matter jurisdiction and dismisses a complaint, it likewise lacks the jurisdictional power to interpret and order specific performance of a contract, the enforceability of which it has decided it has no jurisdiction to try.

B. A Patent Controversy Can Exist Between Licensee and Licensor

1. Lear Permits Licensees to Challenge the Validity of Licensed Patents Without Prior Termination of the License Agreements

Lear, Inc. v. Adkins, 395 U.S. 653, 668 (1969), confirmed that:

> [F]ederal law requires that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent. Sears, Roebuck v. Stiffel Co., [376 U.S. 225 (1964)]; Compco Corp. v. Day-Brite Lighting, Inc., [376 U.S. 234 (1964)].

In furtherance of this federal law the Supreme Court in Lear publicly buried the doctrine of licensee estoppel and sought, as a matter of paramount public policy, to encourage those with the strongest economic incentive to challenge the validity of patents:

> Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain. Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification. [Id. at 670]

Lear involved a patent license agreement entered into prior to the issuance of the underlying patent, which agreement was in effect when the United States Supreme Court heard the

appeal. The Court, noting that the license agreement was still in effect, held that licensee estoppel was no longer viable federal law in the field of patents. Accordingly, the licensee was permitted to challenge the validity of the licensed patent despite the fact that the license agreement had not been terminated. [Id. at 661 et seq.]

The instant appeal presents this Court with an opportunity to lay to rest any lingering doubts which may have survived Lear and establish in this Circuit, once and for all, that a licensee is not required to terminate his license agreement in order to challenge the validity of the underlying patent.

In the seven years since Lear, courts have interpreted its strong statement of federal policy to permit licensees to bring actions in the federal courts under the Patent Laws to establish the invalidity of the licensed patents, and their non-infringement and unenforceablity, without first terminating the license agreement. Furthermore, the federal courts have found that a justiciable controversy is stated by a licensee's attacking the validity of the licensed patents in a declaratory judgment action. This is precisely what Warner-Jenkinson and Kohnstamm have done by commencing the instant action against Allied.

2. The Thiokol Cases (1970-1971) and Milton Roy v. Bausch & Lomb (1976)

In the present case, the District Court relied exclusively on the Thiokol cases as authority for its holding that

a licensee must terminate the license agreement before he can challenge the validity of the licensed patent. It is respectfully submitted that the District Court erred in such reliance in view of more recent decisions discussed infra, including the recent opinion of Judge Caleb M. Wright in Milton Roy Co. v. Bausch & Lomb, Inc., Civ. No. 75-368 (D.Del. Aug. 9, 1976) [copy attached].* Judge Wright is the District Judge who decided Thiokol I and II, which were affirmed in Thiokol III.

A brief analysis of each of these cases is warranted.

a. Thiokol I [313 F.Supp. 253 (D.Del. 1970)]

This was a declaratory judgment action brought by a licensee to declare the underlying patent invalid and unenforceable. At the time the action was commenced, the license agreement was in force. Judge Wright granted the licensor's motion to dismiss under Rule 12(b)(1) Fed.R.Civ.P. holding that as a licensee, plaintiff could n[illegible] he charged with infringement, and therefore there could be no case of actual federal controversy arising under the Patent Laws.** In so holding, the Court declined to follow JFD Electronics Corp. v. Channel Master Corp.,

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* This decision was noted and a copy of the opinion received after the Notice of Appeal was filed.

** In Thiokol Chemical Corp. v. Burlington Industries, Inc. 319 F. Supp. 218, 220 (D.Del. 1970) (Thiokol II), Judge Wright stated:

> It should be clear from the Court's opinion in the first case [Thiokol I] that the decision was premised on the fact that since the licensing agreement between the plaintiff and defendant Burlington was still in effect at the time the suit was filed it was theoretically and practically impossible for the defendant to have "charged" the plaintiff with infringement.

229 F.Supp. 514 (S.D.N.Y. 1964), a pre-Lear case in which a licensee was permitted to seek a declaration of non-infringement, but was estopped from challenging validity.

b. Thiokol II [319 F.Supp. 218 (D.Del. 1970)]

Another declaratory judgment action was brought by the same plaintiff-licensee against the same defendant-licensor, but was commenced after the license agreement was terminated. The Court in this case, denied the licensor's motion to dismiss under Rule 12(b)(1) Fed.R.Civ.P., holding:

> It is apparent that the sole factual difference between this action and the previous one in which the Court found it had no jurisdiction is the termination of the license agreement.... [T]he Court here decides that the termination of the licensing agreement is a determinative jurisdictional factor....
>
> ....
>
> ...[T]he legal barrier [the licensing agreement] to a "charge of infringement" is eliminated.... [319 F.Supp. at 220]

c. Thiokol III [448 F.2d 1328 (3d Cir. 1971)]

This was a consolidated appeal from Thiokol I and II in which the Third Circuit Court of Appeals affirmed Thiokol I on the ground that the controversy did not arise under the Patent Laws. Thiokol II was affirmed on the ground that a federal controversy was pleaded.

In considering Thiokol I, the Court did not expressly

address itself to the threshold question of whether, as a matter of law, a federal controversy could exist before termination of the licensing agreement. By going to the question of the nature of the controversy, appellants submit that the Third Circuit Court of Appeals assumed that termination is not required in order for a controversy to exist.* However, in this case Judge Frankel did not reach the question of the nature of the controversy, holding only that a controversy cannot exist prior to termination. Thus, the threshold question is squarely before this court.

d. Milton Roy Co. v. Bausch & Lomb Inc. [Civ. No. 75-368 (D.Del. Aug. 9, 1976)]

In this case Milton Roy Co. (Milton Roy) brought a declaratory judgment action seeking a declaration of invalidity and non-infringement of certain patents. The defendants included the patentee, the Czechoslovak Academy of Sciences, and its exclusive licensee, National Patent Development Corp. (National). A further defendant was National's exclusive sublicensee, Bausch & Lomb, Inc. (Bausch & Lomb). Bausch & Lomb cross-claimed against National, urging that the patents under which Bausch & Lomb was licensed were invalid, or unenforceable. The issue before the District Court arose on National's motion to dismiss Bausch & Lomb's cross-claim.

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* That Court so held in American Sterilzer Co. v. Sybron Corp., 526 F.2d 542 (3d Cir. 1975), infra, p. 16.

National, in its motion under Rule 12(b) Fed.R.Civ.P. to dismiss "Count I" of the cross-claim, asserted that the Court lacked jurisdiction because there was no case or controversy between it and Bausch & Lomb in as much as Bausch & Lomb was a licensee of National and had not terminated its license agreement. National cited the Thiokol cases in support of its motion. In denying the motion, the Court rejected National's argument:

> First it is clear in this Circuit that under the doctrine of Lear, Inc. v. Adkins, 395 U.S. 653 (1969), licensees need not repudiate or terminate their licenses prior to bringing suit. See American Sterilizer v. Sybron Corp., 526 F.2d 542 (3rd Cir. 1975)....
>
> It is not denied that B & L presently manufacture soft lenses, and that absent the license it would be an infringer if the patent is valid.... The mere existence of the license relationship and the lack of direct accusation of infringement in this case is not enough for this Court to say that no case or controversy exists. It is clear that National intends to defend the patent, and that B & L has a reasonable apprehension of being accused of infringement. Moreover, as Lear, supra, made clear, B & L has a substantial economic stake in a determination of invalidity or non-infringement. The Court holds that the interest of B & L in continuing to manufacture the lenses without a license and the substantial and reasonable fear that if it cancelled the license, it would be sued on infringement establishes an actual controversy between the parties and is sufficient to establish the right to bring the declaratory action. See Eastman Kodak v. SGK, 392 F.Supp. 1156; Thiokol II, 319 F.Supp. at 221. [Slip op. at 7-8]

A similar motion to dismiss "Count II" of the cross-claim was also denied. "Count II" sought a declaration of invalidity or unenforceability of certain other National patents licensed to Bausch & Lomb but which were not part of the <u>Milton Roy</u> Complaint. The Court ruled:

> [T]he Court is satisfied that jurisdiction as to Count II rests in this Court. As the Court has noted above, the financial stake of B & L and its reasonable apprehension of an infringement action as part of National's enforcement of its rights in the event it cancels the license provide a basis for it to seek a declaration of invalidity. The force and scope of the Declaratory Judgment action as a vehicle for the early determination of rights would be restricted unduly if it were held otherwise. <u>Cf.</u>, Eastman Kodak v. SGK, 392 F.Supp. at <u>1158</u>. And other important public policies would be ill served. <u>See</u> American Sterilizer v. Sybron Corp., 526 <u>F.2d</u> 542 (3rd Cir. 1975).
>
> Nor does <u>Thiokol</u> block the application here. In light of the <u>Amsco</u> [American Sterilizer] opinion, <u>supra</u>, it is clear that a licensee is entitled to sue in this Circuit without terminating the agreement. Since the allegations in the second count concern solely the claims of the patents and their validity, the action is one "arising under" the patent laws, and therefore is within 28 U.S.C. §1338. [Slip op. at 9-10]

It is submitted that the holding in <u>Thiokol I</u>, which required a licensee to terminate before challenging the validity of the licensed patent, has now been abandoned by the very Court that rendered it. Consequently, the reliance by the District Court in this case on the <u>Thiokol</u> rationale is fatally weakened by the <u>Milton Roy</u> decision. In view of the authorities cited

herein, this Court should now give "prior termination" a decent burial.

3. Other Authorities Permit Licensees to Challenge Patent Validity Without Prior Termination of Their License Agreements

In American Sterilizer Co. v. Sybron Corp., 526 F. 2d 542 (3d Cir. 1975), the Third Circuit Court of Appeals reinstated plaintiff-licensee's declaratory judgment counts seeking to have the licensed patent declared invalid and not infringed. The District Court had refused to permit the licensee to attack the validity of the patents without first terminating the license agreement and accordingly dismissed the patent counts which had been brought under 28 U.S.C. §1338(a). [Id. at 544-45] The Court of Appeals reversed that ruling and held that the federal policy of promoting free competition in ideas which do not merit patent protection, as expressed in Lear, required that a licensee be permitted to contest the validity of a licensed patent without first terminating the license agreement, and that such an action by the licensee arose under patent law conferring jurisdiction under 28 U.S.C. §1338(a).

> May a [plaintiff] patent licensee challenge the scope and validity of the underlying patent without first terminating its license agreement? The district court answered this question in the negative.... We reverse, holding Lear, Inc. v. Adkins, 395 U.S. 653, 89 S.Ct. 1902, 23 L.Ed.2d 610 (1969) controls. [526 F.2d at 543]

Thus, the Third Circuit concluded that the ability to terminate was irrelevant to the licensee's right to challenge

validity under Lear:

> [T]he Supreme Court's reference to "muzzling" in Lear does not depend upon the presence or absence of a license termination clause. [Id. at 546]

The jurisdictional basis for the present action is dealt with in Medtronic, Inc. v. American Optical Corp., 327 F. Supp. 1327 (D.Minn. 1971) where the Court had before it a factual situation virtually identical with that presented here. Plaintiff-licensee sought a declaratory judgment under 28 U.S.C. §§2201 and 2202 that defendant's (licensor's) licensed patent ("the '990 patent") was invalid and not infringed. The licensee alleged jurisdiction as arising under the Patent Laws of the United States, 28 U.S.C. §1338. [327 F.Supp. at 1330]

The licensor moved to dismiss the Complaint under Rule 12(b)(6) Fed.R.Civ.P. on the ground that there was no jurisdiction over the subject matter. The licensor argued that since the license agreement had not been terminated there could be no actual controversy between the parties. [Id. at 1328, 1330-31] In denying the motion the Court rejected the licensor's argument that:

> Because there is a license, there can be no charge; because there is no charge, there can be no controversy; because there is no controversy, this Court lacks jurisdiction. [Id. at 1331]

The Court found authority for its holding that the mere existence of a license agreement does not prevent the creation of a justiciable controversy between licensee and licensor

in Lear, Inc. v. Adkins, supra, and Beckman Instruments, Inc. v. Technical Development Corp., 433 F.2d 55 (7th Cir. 1970), cert. denied, 401 U.S. 976 (1971), and stated:

> In Lear the Supreme Court abolished the doctrine of licensee estoppel and enunciated the strong public policy that patent validity should be open to challenge by licensees. In Beckman a sub-licensee brought a declaratory judgment action challenging the validity of the patent while the license agreement was in effect, and also alleging the illegality of that agreement. The Seventh Circuit reversed the district court's summary judgment for defendant on the authority of Lear.
> ....
> Two points are noteworthy about the Seventh Circuit's ruling; it did not require Beckman to terminate the license before bringing its action and it interpreted Lear as enunciating a policy of removing legal and economic barriers to patent challenges by licensees. This Court accepts the Seventh Circuit's interpretation of Lear in toto. [327 F.Supp. at 1331]

In this connection, the Minnesota District Court expressly declined to follow the "far more restrictive reading of Lear" in Thiokol I. [327 F.Supp. at 1332] As a matter of policy dictated by Lear, the Court refused to force licensees to take the "drastic" steps required by the Thiokol cases in order to seek judicial relief under the Declaratory Judgment Act:

> While the Thiokol cases can be distinguished on their facts, it must be conceded that they give a far more restrictive reading of Lear than this Court does. Moreover, the cases reveal the drastic steps which a

> licensee must take when judicial relief under the Declaratory Judgment Act is denied at an early stage in the controversy. One purpose of this Act is to permit a potential defendant to obtain an adjudication of his rights and obligations under a contract without first breaching that contract and incurring damages which may imperil its very existence. Actual controversies can thus be settled before they result in the accrual of damages or termination of the contract. [327 F.Supp. at 1332]

> The Court also concluded that:

> [A]n action for a [declaration of invalidity or non-infringement] of a licensed patent is also a suit under the patent laws. Accordingly, this Court finds it has patent law jurisdiction over the controversy surrounding the '990 patent. [Id. at 1332-33]

In Atlas Chemical Industries, Inc. v. Moraine Products, 509 F.2d 1 (6th Cir. 1974), plaintiff-licensee sought a declaratory judgment of invalidity of the patent under which it was licensed. Jurisdiction was asserted on the authority of Lear, Inc. v. Adkins, supra. In that case the District Court found the patent invalid, but ordered that royalties payable under the license agreement, which had been ordered to be placed in escrow during the pendency of the litigation, be paid over to the defendant-licensor. The Court of Appeals for the Sixth Circuit affirmed the finding of invalidity, but reversed the order to turn the escrowed monies over to the patentee:

> The present suit is an action by a licensee, Atlas, attacking the validity of a patent owned by the licensor, Moraine. The instant case is the type of suit authorized

by Lear v. Adkins.

> ...The right of Atlas to bring this action as licensee to litigate the validity of the patent therefore is unquestioned. (Emphasis by the Court). [Id. at 5]

Similarly, in PPG Industries, Inc. v. Westwood Chemical, Inc., 530 F.2d 700, 707 (1976), the Sixth Circuit citing American Sterilizer, supra, stated:

> We are not persuaded that it is necessary for the licensee to repudiate the agreement in order to encourage an adjudication of invalidity.... [T]he Supreme Court's reference to "unmuzzling" in Lear does not depend upon the presence or absence of a termination clause.

In Dahlgren Manufacturing Co. v. Harris Corp., 399 F. Supp. 1253 (N.D.Tex. 1975), defendant-licensee was sued for appropriation of trade secrets and breach of contract. The licensee counterclaimed for a declaratory judgment that the licensed patents were invalid. The Court posed the issue as follows:

> The issue presented is whether in these circumstances a declaratory judgment action creates an actual case or controversy arising under the patent laws and invoking the jurisdiction of this federal court. [399 F.Supp. at 1254]

And it held that:

> [T]he Lear analysis is dispositive of the question of whether the presentation of a patent validity issue by the licensee raises a justiciable controversy. It is apparent that the question of the validity of the Dahlgren patents pervades the entire history of the conflict between the parties.

> To hold that the Defendant's first counterclaim does not present a justiciable issue would be to ignore the realities of the parties' relationship. It was this type of situation that the Lear decision was meant to cure. [Id. at 1256]

In so holding, the Court found an actual controversy to exist over the licensed patents and rejected the licensor's reliance on Thiokol I, supra, for the proposition that there was no declaratory judgment jurisdiction since the license was in effect and there had been no charge of infringement. [Id.]

Note also, Hanes Corp. v. Millard, 531 F.2d 585,594 n.8 (D.C. Cir. 1976), wherein the Court of Appeals for the District of Columbia rejected the Thiokol rationale and stated that a licensee may file a declaratory judgment action under 28 U.S.C. §1338 to declare the underlying patent invalid.

An early post-Lear case in the Southern District of New York indicated that no controversy arising under the Patent Laws could exist where the license agreement between the licensor and licensee had not been terminated. W.R. Grace & Co. v. Union Carbide Corp., 319 F.Supp. 307 (S.D.N.Y. 1970). In Grace, the court relied upon Thiokol I, supra, for the proposition that a licensee could n[illegible] charged with infringement by his licensor and therefore a patent controversy could not exist.

> In further support of the finding that the issues presented herein are academic and consequently outside of this Court's jurisdiction, is the fact that Grace has remained a licensee of Carbide. Had the license been terminated...a controversy could have existed if Carbide charged Grace with infringement. (Citing Thiokol I). [319 F.Supp. at 311]

In Bahamas Paper Co. v. Imperial Packaging Corp., 58 F.R.D. 355 (S.D.N.Y. 1973), a suit by the licensor for royalties, the District Court indicated that the licensor was entitled to a separate trial under Rule 42, Fed.R.Civ.P. on the issue of when the licensee repudiated the license agreement. This decision was based on the view that patent invalidity is no defense in an action for royalties due prior to termination or challenge to validity, and is in apparent conflict with an earlier ruling by another judge in this case. In Bahamas Paper Co. v. Imperial Packaging Corp., 328 F.Supp. 158 (S.D.N.Y. 1971) the Court, relying upon Lear, Inc. v. Adkins, supra, held that by challenging the validity of the licensed patents a licensee can defend a suit for royalties due for the period prior to termination.

The question here on appeal is controlled by the rule of law set forth in Lear, as implemented by American Sterilizer, Medtronic, Atlas Chemical, PPG Industries, Dahlgren, Hanes and Milton Roy. In view of these authorities it is respectfully submitted that the District Court erred in holding that, as a matter of law, there could be no case of actual controversy in view of the non-terminated license agreement. The Complaint should be reinstated.

4. A Stipulation and Order of Dismissal Without Prejudice Has No Res Judicata Effect

The previous action by Warner-Jenkinson and Kohnstamm against Allied was, to the extent it sought a declaratory judgment with respect to the invalidity, unenforceability and non-

infringement of Allied's patents, dismissed without prejudice by negotiated agreement of all the parties and "So Ordered" by the District Court.*

It is well established that a dismissal without prejudice is accorded no res judicata or collateral estoppel effect. See, e.g., American Heritage Life Insurance Co. v. Heritage Life Insurance Co., 494 F.2d 3, 9 (5th Cir. 1974); King v. Mordowanec, 46 F.R.D. 474, 481 (D.R.I. 1969); Cornell v. Chase Brass & Copper Co., 48 F.Supp. 979, 981 (S.D.N.Y. 1943), aff'd, 142 F.2d 157 (2d Cir. 1944). Thus, stipulated dismissals without prejudice are distinguished from consent decrees adjudicating validity and infringement which are accorded res judicata effect. See, e.g., Wallace Clark & Co. v. Acheson Industries, Inc., 394 F.Supp. 393 (S.D.N.Y. 1975), aff'd, 532 F.2d 846 (2d Cir. 1976), where the District Court stated:

> To permit plaintiff to reassert in this suit the same claims it advanced in its first action is tantamount to relegating all consent decrees in patent suits of this kind to the status of a voluntary dismissal without prejudice under Rule 41(a) of the Federal Rules of Civil Procedure, with the end result as if the action had not been brought in the first place. (Citations omitted). [394 F.Supp. at 401]

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* Rule 41. [Fed.R.Civ.P.]
DISMISSAL OF ACTIONS
(a) Voluntary Dismissal: Effect Thereof.
(i)...[A]n action may be dismissed... (ii) by filing a stipulation of dismissal signed by all parties who have appeared in the action. Unless otherwise stated... the dismissal is without prejudice....

Here, in the settlement negotiations leading to the stipulated dismissal without prejudice of the patent issues in the prior litigation, Allied at first sought a consent decree which under Wallace Clark would have barred relitigation. However, when Warner-Jenkinson and Kohnstamm objected, Allied relented and agreed to a stipulated dismissal without prejudice.

Ambiguous judgments can, of course, create problems of interpretation. Brunswick Corp. v. Chrysler Corp., 408 F.2d 335 (7th Cir. 1969). In such situations it may be necessary to determine the intentions of the parties. However, in the prior litigation, where the stipulated dismissal of the patent claims was without prejudice and the dismissal of the unfair competition claims was with prejudice, no problem of interpretation can arise.

Applicants are aware of only one case in which a license agreement entered into pursuant to a dismissal without prejudice has been held to be a bar against further litigation. Aro Corp. v. Allied Witan Co., 531 F.2d 1368 (6th Cir.), petition for cert. filed, 45 U.S.L.W. 3171 (Aug. 31, 1976) (No. 76-155). Moreover, the Aro decision should be read as limited to its peculiar facts. In Aro there was a maximum potential liability of $1,668 on a patent which had but 3-1/3 years until its expiration. Further there was no evidence that the public was without alternative unpatented products. [531 F.2d at 1373-74] Accordingly, the Aro court concluded that the interest to be served by providing the licensee an opportunity to litigate validity was outweighed by an interest in enforcing the dismissal

agreement.

Although Warner-Jenkinson and Kohnstamm consider the Aro opinion as being a dubious precedent, particularly in view of the fact that no other cases have been found in which a dismissal without prejudice has been held to bar further litigation, it is clear that the factors which dictated the Aro decision are absent here. [See id. at 1373-74] Instead of a potential maximum royalty of $1,668, Warner-Jenkinson and Kohnstamm here face royalties of about $200,000 per quarter. Instead of a 3-1/3 year term remaining, the patents here at issue have terms which extend to at least July, 1987. Rather than having available an unpatented alternative, Warner-Jenkinson and Kohnstamm are foreclosed by the F.D.A. from utilizing any product but Allied's patented product. Accordingly, even under the Aro rationale the earlier dismissal without prejudice should not preclude this litigation.

C. Deposit of Royalties Into Escrow Preserves the Status Quo in Accordance With Federal Policy and Will Avoid Irreparable Injury

In its Order and Judgment of August 13, 1976 the District Court denied the motion of Warner-Jenkinson and Kohnstamm to permit deposit of royalties into escrow *pendente lite*. However, the Court did not decide the merits of the escrow question; it merely denied the motion in view of its Order dismissing the Complaint.*

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* Although Judge Frankel did not reach the merits of depositing royalties into escrow *pendente lite* at the August 11th hearing, at the June 30th hearing he did order that royalty payments could be withheld pending his decision on the escrow motion. [A-32]

1. Escrow of Royalties Preserves the Status Quo in Accordance With Federal Policy

The deposit of royalties into escrow, which Warner-Jenkinson and Kohnstamm seek, is a fair and "commendable" procedure which preserves the status quo during the litigation. If the patents are held invalid, an undeserving patentee will not be unjustly enriched; if the patents are held valid, then funds under the control of the Court are available for payments to the patentee. In either event, escrow permits the licensee to exercise his federal right to challenge the patent while maintaining the license.

The desirability of escrow as a method of preserving the status quo was discussed in Atlas Chemical Industries, Inc. v. Moraine Products, supra.

> [E]scrow is a commendable procedure to preserve the status quo during the course of litigation, the funds belong to neither party until the validity of the patent is determined. [509 F.2d at 7]

The equitable and salutory effect of a royalty escrow was again considered in PPG Industries, Inc. v. Westwood Chemical, Inc., supra, wherein a licensee suit to declare a licensed patent to be invalid was considered to be:

> the type of suit authorized by Lear....[T]he factual situation in Atlas Chemical [where royalties were escrowed] encouraged an early adjudication of invalidity. (Emphasis added). [530 F.2d at 705]

Escrow has been approved in other contexts as well, e.g., Javins v. First National Realty Corp., 428 F.2d 1071, 1083 n.67

(D.C.Cir.), cert. denied, 400 U.S. 925 (1970) (escrow of rents was noted to be an "excellent protective procedure" pending outcome of a landlord-tenant dispute).

In the instant case, Warner-Jenkinson and Kohnstamm desire to preserve their licenses if, contrary to their urging, the patents are held valid. However, under Lear, Inc. v. Adkins, supra, and cases following, the maintenance of the status quo requires that royalties not be paid to Allied while the question of validity is being tried. In Lear, supra, the Supreme Court declared the strong federal policy that a patent licensee must be permitted to avoid payment of royalties to a licensor while the licensee was challenging the validity of the licensed patents. In striking a balance between competing interests of the licensor on the one hand, and the licensees and public on the other, Warner-Jenkinson and Kohnstamm submit that escrow presents the only practical way to satisfy their private interests and to advance the public interest in having a prompt adjudication and in preventing dilatory tactics. According to the Court in Lear:

> The decisive question is whether overriding federal policies would be significantly frustrated if licensees could be required to continue to pay royalties during the time they are challenging patent validity in the Courts.
>
> It seems to us that such a requirement would be inconsistent with the aims of federal patent policy. Enforcing this contractual provision would give the licensor an additional economic incentive to devise every conceivable dilatory tactic in an effort to postpone the day of final judicial reckoning. We can perceive no

> reason to encourage dilatory court tactics in this way. Moreover, the cost of prosecuting slow-moving trial proceedings and defending an inevitable appeal might well deter many licensees from attempting to prove patent invalidity in the courts.... [W]e hold that Lear [the licensee] must be permitted to avoid the payment of all royalties accruing after Adkin's [the licensor's] 1960 patent issued if Lear can prove patent invalidity. [395 U.S. at 673-74]

Likewise, the licensee who challenges the validity of the licensed patents should not be forced to alter the <u>status quo</u> by withholding royalties. By such conduct the licensee risks an infringement suit by the licensor seeking injunctive relief and damages. In this case Allied has expressly threatened to bring such a suit. By permitting suits without prior termination, <u>Lear</u> "unmuzzled" licensees and thus sought to encourage suits by licensees against licensors to contest the validity of licensed patents without prior termination of the license agreement. <u>PPG Industries, Inc.</u> v. <u>Westwood Chemical, Inc.</u>, 530 F.2d 700, 707.

The escrow arrangement proposed by Warner-Jenkinson and Kohnstamm will achieve the purposes of <u>Lear</u> in a manner which is fair to all parties and promotes the public interest in a speedy determination of whether or not the licensed patents are valid. The licensees would not be forced to pay royalties to Allied during the course of the litigation in contravention of the <u>Lear</u> decision, nor would they be required to breach their license agreements and incur the risk of an infringement suit in order to challenge the validity of the licensed patents.

2. Payment of Royalties to Allied *Pendente Lite* Would Be "Unjustified"

For a licensee to pay royalties to a patentee during litigation under a patent ultimately held to be invalid would be a double tax on the licensee, both by unjustified royalty payments and by payments of its legal fees. This "double tax" coupled with the presumption of patent validity would favor patentees so heavily as a class in litigation that *Lear's* shouted encouragement to licensees to challenge validity would be reduced to a mere whisper. *Lear* has also decided this issue:

> A patent, in the last analysis, simply represents a legal conclusion reached by the Patent Office. Moreover, the legal conclusion is predicated on factors as to which reasonable men can differ widely. Yet the Patent Office is often obliged to reach its decision in an *ex parte* proceeding, without the aid of the arguments which could be advanced by parties interested in proving patent invalidity. Consequently, *it does not seem to us to be unfair to require a patentee to defend the Patent Office's judgment when his licensee places the question in issue*, especially since the licensor's case is buttressed by the presumption of validity which attaches to his patent. (Emphasis added). [395 U.S. at 670]

In this regard, the Supreme Court in *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974), quoted the Court of Appeals for the Second Circuit in *Painton & Co.* v. *Bourns, Inc.*, 442 F.2d 216 (2d Cir. 1971), to point out the inequity inherent in the continuation of royalty payments *pendente lite*:

> [A patent] may well be invalid, yet many will prefer to pay a modest royalty

than to contest it, even though Lear allows them to accept a license and pursue the contest without paying royalties while the fight goes on. The result in such a case would be unjustified royalty payments.... (Emphasis added). [416 U.S. at 488]

3. Licensees Warner-Jenkinson and Kohnstamm Face Irreparable Injury if Escrow *Pendente Lite* is Not Permitted

Warner-Jenkinson and Kohnstamm desire to preserve their status as licensees *pendente lite*; only if the underlying patents are finally held to be invalid do they want to terminate their license agreements. However, if they find themselves in a position where they must pay royalties to Allied in order to protect their position as licensees and at the same time support patent litigation, they will be forced to reconsider the advisability of proceeding with this litigation. In other words, they may be thereby "muzzled" resulting in continued payments of tribute for patents which they believe to be invalid.

Alternatively, if they do pay royalties while continuing the litigation and they win, there are no authorities upon which to rely holding that recoupment of royalties paid *pendente lite* is mandatory. Cf. *USM Corp.* v. *Standard Pressed Steel Co.*, 524 F.2d 1097 (7th Cir. 1975) (where the Court declined to commit itself to a return of royalties in the event that the patents were invalidated). In that case, the question of the *res judicata* effect of a previous *consent judgment* was unresolved.

Even if the Court were to make an order that royalties

paid to Allied pendente lite be returned to Warner-Jenkinson and Kohnstamm in the event that the patents are declared invalid, not infringed or unenforceable, it is predictable that further litigation would ensue before return payment actually would be made. Assuming that a final determination will take a minimum of two years, it is a fact of life, of which the Court should take judicial notice, that re-payment of approximately $1,800,000* plus interest, does not come easily, even for a corporation the size of Allied. An escrow arrangement as proposed by Warner-Jenkinson and Kohnstamm will avoid multiple litigation.

Of course, if Warner-Jenkinson and/or Kohnstamm decide to stop payment of royalties and maintain the challenge to the patents, Allied's declared intention of suing for patent infringement raises the possibility of injunctive relief if the patents are held to be valid, infringed and enforceable. This is the result that Lear sought to preclude.

Accordingly, approving the deposit of royalties into escrow will preserve the status quo between the litigating parties, fulfill the federal policy of encouraging those with the greatest incentive to challenge invalid patents, prevent irrepar-

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* Estimating quarterly royalties of about $200,000 for nine quarters (June 1976 - June 1978).

The dictum in Milton Roy Co. v. Bausch & Lomb Inc., supra, at 14-15, does not dispel the probability of further litigation in order for Warner-Jenkinson and Kohnstamm to recover royalties paid to Allied pendente lite.

able injury to Warner-Jenkinson and Kohnstamm if the patents are invalidated, and at the same time insure a fund from which to pay Allied if the patents are upheld. Fairness to all compels approval of the proposed escrow agreement.

D. The Lack of Subject Matter Jurisdiction Deprives the Court of the Jurisdictional Power to Issue a Further Order Compelling Payment of Royalties

The Order to pay royalties can be traced to a conference with Judge Frankel held on June 23, 1976. At that conference the Court approved the temporary withholding of the June 30, 1976 royalties, and Warner-Jenkinson and Kohnstamm thereafter submitted a proposed order, the last paragraph of which contained alternative provisions that:

> 2. Until the decision of this Court respecting the relief sought by plaintiffs [Warner-Jenkinson and Kohnstamm] set forth in the Order to Show Cause, plaintiffs may withhold their royalty payments due on June 30, 1976 under their license agreements with defendant dated as of March 1, 1975, without prejudice to their rights under said license agreements with defendant, and specifically without incurring a breach of said agreements by reason of said non-payment of royalty. If defendant [Allied] prevails in opposition to the relief sought by plaintiffs, plaintiffs will either pay said royalties due June 30, 1976 plus 6% interest on said sums for the period withheld or suffer the consequences of their failure to make said royalty payments on or before June 30, 1976. [A-32]

On June 30, 1976, Judge Frankel signed the proposed order but deleted the alternative provision:

> or suffer the consequences of their failure to make said royalty payments on or before June 30, 1976. [A-32]

On August 13, 1976 Judge Frankel entered Allied's proposed order dismissing the Complaint for lack of subject matter jurisdiction. Over the objections of Warner-Jenkinson and Kohnstamm, the Order included the now appealed from Paragraph 3, which provides that:

> 3. Plaintiffs [Warner-Jenkinson and Kohnstamm] shall pay to defendant [Allied], within fifteen (15) days of the entry of this Order, the royalties which were due June 30, 1976, plus 6% interest on said royalties for the period withheld, and which are authorized to be temporarily withheld pursuant to this Court's Order of June 30, 1976, said order having been sought by plaintiffs. [A-240]

The last phrase, namely "said order having been sought by plaintiffs", was inserted by the Court after Warner-Jenkinson and Kohnstamm urged that the Court was without the jurisdictional power to make such an Order following dismissal of the Complaint on jurisdictional grounds. After the entry of the Order, the Court was advised of Warner-Jenkinson and Kohnstamm's belief that such an order was not sought by them in view of the sequence of events set forth above.

Once the District Court ruled that it was without subject matter jurisdiction its power was limited to issuing an order of dismissal and setting aside previously issued orders which became improper with the discovery of want of jurisdiction.

> Where the circuit court is without jurisdiction, it is in general irregular to make any order in the cause except to dismiss the suit; but that rule does not apply to the action of

> the court in setting aside such orders as had been improperly made before the want of jurisdiction was discovered. The New Orleans & Bayou Sara Mail Co. v. Fernandez, 79 U.S. (12 Wall.) 130,136 (1870).

Here, however, the District Court coupled its dismissal order with an order requiring payment of the June 30, 1976 royalties. This royalty payment order is beyond the jurisdictional power of the Court, since it is, in effect, an order for specific performance and a money judgment rendered in favor of Allied in a case in which the Court held that it lacked jurisdiction. The result is a judicial compulsion to pay royalties while depriving Warner-Jenkinson and Kohnstamm of an opportunity to present and try the merits of their case.

Where dismissal of a cause is based on a court's being without jurisdiction, the court lacks the jurisdictional power to make any order in the cause except to dismiss the suit. Stickney v. Wilt, 90 U.S. (23 Wall.) 150,162 (1874). See also, Coleman v. Hudson River Bridge Co., 6 F.Cas. 62 (No. 2,983) (C.C.N.D.N.Y. 1862) (where the Court is without jurisdiction to entertain suit, it is also without jurisdiction to grant a stay pending appeal); E.K. Carey Drilling Co. v. Murphy, 113 F.Supp. 226,227 (D.Colo. 1953) ("where the federal court is without jurisdication, it is improper to make any order in the cause except to dismiss the suit"); Burdett v. Doty, 38 F.491 (C.C.E.D. Mich. 1889) (action of replevin; where action was dismissed for want of jurisdiction, it was improper to assess damages against the plaintiff because

of the seizure of property under the writ). In Burdett, the Circuit Court stated that:

> The difficulty in the present case is that the court, after dismissing the case for want of jurisdiction, proceeded to a step which could only be taken upon the theory that the court had jurisdiction, viz., the return of the property and the assessment of defendant's damages. [38 F. at 492]

In Musher Foundation v. Alba Trading Co., 127 F.2d 9,11 (2d Cir.), cert. denied, 317 U.S. 641 (1942), this Court noted that:

> [W]hen the court dismissed the second cause of action because federal jurisdiction was lacking it had no power to pass upon the merits of the claim. Absence of federal jurisdiction over the subject-matter necessarily rendered further consideration of the claim impossible and made all further questions nonjusticiable.

In summary, once the District Court dismissed the Complaint for lact of subject matter jurisdiction, it had no jurisdictional power to order payment of the June 30, 1976 royalties. The Order to pay the June 30, 1976 royalties should be vacated.

VI. CONCLUSION

On reason and authority, the final Order and Judgment of the District Court should be reversed by ordering that the Complaint be reinstated, that the District Court grant the escrow motion of Warner-Jenkinson and Kohnstamm and that the order to pay the June 30, 1976 royalties be vacated.

Respectfully submitted,

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Date Received 8-76

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF DELAWARE

MILTON ROY COMPANY and MILROY-AUTOMATED, INC., Plaintiffs, v. BAUSCH & LOMB INCORPORATED, NATIONAL PATENT DEVELOPMENT CORPORATION, FLEXIBLE CONTACT LENS CORPORATION, FLEXIBLE CONTACT LENS (NEVADA), INC., and CZECHOSLOVAK ACADEMY OF SCIENCE, Defendants.	)	Civil Action No. 75-368

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O P I N I O N

Wilmington, Delaware
August 9, 1976

WRIGHT, Senior Judge.

This case concerns the validity and enforceability of certain patents relating to the manufacture of so-called "soft contact lenses" ("soft lenses").[1] The patents at issue are owned by the Defendant Czechoslovak Academy of Sciences, which has exclusively sublicensed them to the Defendant National Patent Development Corp., which in turn sublicensed them to its subsidiaries, Flexible Contact Lens Corp. and Flexible Contact Lens (Nevada); Inc.[2] The National defendants in turn granted an exclusive sublicense to Defendant Bausch & Lomb, Inc. ("B & L"), as part of an agreement covering the exchange of techniques and the development and marketing of such lenses. The plaintiffs in the instant case, Milton Roy Company and MilRoy-Automated, Inc. ("MilRoy"), are corporations about to begin the manufacture and distribution of soft lenses under authority granted by the Food and Drug Administration. MilRoy brought the action seeking relief in the form of a

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1 Soft lenses differ from "hard lenses" in that they are flexible enough to follow more closely the contours of the eye, and they are thus less likely to cause some kinds of eye irritation, and less likely to "pop out" while being worn.

2 For convenience these defendants (the Czech Academy, and the National corporations) are herein referred to as "the National defendants" or simply "National".

declaration of invalidity or non-infringement of the patents.[3]

At the time this action was filed, there was pending in the United States District in Colorado a related action filed by B & L and joined by the National defendants against Automated Optics, Inc., which supplies plaintiff here with the material used to form the soft lenses (the "Colorado Action"). There are also pending actions in the Southern District of New York and the New York Supreme Court with regard to the contract between B & L and the National defendants ("New York actions").[4]

Presently before this Court are motions which relate solely to efforts of the defendants herein to determine which Court will rule on various aspects of the relationship of B & L with the National defendants. In both the Colorado action and this action, B & L has sought to invoke a cross claim against the National defendants, urging that the patents under which it is licensed to manufacture the lenses are invalid, or unenforceable for fraud. B & L continues to urge in each case,

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3 The patents which the plaintiff MilRoy has sought to have declared invalid or unenforceable are: United States Letters Patent 3,361,858 ("the '858 patent"); Reissue Patent 27,401 ("the '401 patent"); and United States Letters Patent 3,822,089 ("the '089 patent").

4 The Czech Academy is not presently a party in the New York State suit, but counsel for National has asserted it would join if it were required. The State action is under the B & L-National agreement and seeks a determination of royalties. Counterclaims are pending there. The suit in the Southern District alleges a repudiation by B & L of the license and includes an anti-trust claim.

however, that if the patents are valid and enforceable, then other manufacturers are infringing and should be enjoined.

The motions before the Court are the National defendants' motion to strike B & L's answer and to dismiss the three counts of B & L's counterclaim. Also pending is B & L's motion to require that the payments due under the National-B & L agreement be paid in escrow pending the outcome of the suit; and to forbid National from terminating the agreement between B & L and the National defendants, or committing any act inconsistent with B & L's alleged rights. The Court interprets this motion as praying for injunctive relief pursuant to Rule 65, Fed.R.Civ.Proc.

The issues were briefed by the parties, the Court heard oral argument, and requested each side to provide proposed findings of fact and conclusions of law. This opinion shall embrace any findings of fact and conclusions of law required by Rule 52, Fed.R.Civ.Proc.[5] The issues are treated seriatim, the motions to strike and dismiss treated first.

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5 Rule 52 provides: "[I]n granting or refusing interlocutory injunctions the court shall. . .set forth the findings of fact and conclusions of law which constitute the grounds for its action."

National's Motions

1. Motion to Strike

National urges that B & L's answer ought to be stricken as "inappropriate" since it purports to answer that the three patents put in issue by MilRoy are in fact invalid or unenforceable. B & L urges that it is entitled to plead the facts which it believes to be the truth.

Motions to strike are generally not favored, and will not be granted unless some end of justice is accomplished thereby, even if, e.g., the defense raised is insufficient. See Louisiana Sulphur Carriers v. Gulf Resources and Chem. Corp., 53 F.R.D. 458 (D.Del. 1971). The Court is satisfied here that the admission of facts against the interest of a co-defendant does not bring an answer within the ground for striking permitted by Rule 12(f), Fed.R.Civ.Proc.[6] Insofar as the pleading is an admission, it is an admission only against B & L, and cannot be used by the plaintiff to affect the interests of the National defendants. National's motion to strike the answer is therefore denied.

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6 Rule 12(f) provides in pertinent part: "[T]he court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter."

2. Motions to Dismiss

The standards for determining a motion to dismiss a counter-claim are the same as for determining a motion to dismiss a complaint. See Rule 12(b); 2A Moore's Federal Prac. ¶ 12.06[2] (2d ed.). All the relevant statements of fact contained in the counterclaim must be accepted as true, and the benefit of reasonable inferences given to the complainant. Hospital Bldgs. Co. v. Rex Hospital, ___U.S.___, 44 U.S.L.W. 4683 (May 24, 1976).

The motions here are brought on jurisdictional grounds. National asserts that this Court lacks jurisdiction to determine the counts because they do not properly arise under 28 U.S.C. § 1338;[7] and that there is no case or controversy between B & L and National. Since the facts differ slightly as to each of the counts, they are dealt with separately. It should be noted at the outset, however, that only such jurisdiction as is granted by 28 U.S.C. § 1338, or by pendent or ancillary jurisdiction, see United Mineworkers v. Gibbs, 383 U.S. 715 (1966), is available here. There is no diversity between B & L and

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7 28 U.S.C. § 1338 provides: "The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents, plant variety protection, copyrights and trade-marks. Such jurisdiction shall be exclusive of the courts of the states in patent, plant variety protection and copyright cases."

National to save claims which might otherwise be brought under state law. It is also clear in this Circuit that the Declaratory Judgment Act, 28 U.S.C. §§ 2201, 2202, is not a separate grant of jurisdiction. See Schilling v. Rogers, 363 U.S. 666, 677 (1960); Ragoni v. United States, 424 F.2d 261, 264 (3rd Cir. 1970); StamiCarbon, N.V. v. Chemical Const'n. Corp., 355 F.Supp. 228, 232 (D.Del. 1973).

A. Count I.

Count I of the B & L counterclaim is asserted to be brought under pendent and ancillary jurisdiction, and 28 U.S.C. § 1338. It recites that the '858; '401' and '089 patents are, in fact, invalid and unenforceable; and seeks a declaration to that effect. National urges that since B & L is a licensee, no claim of infringement can reasonably be made against it. Therefore on the fact of the pleadings, there is no case or controversy. B & L replies that although it is indeed a licensee and it has not terminated the agreement, it was in fact accused of infringement in the case brought by National in the Southern District of New York.

Insofar as Count I is concerned, it is clear that the issue will be tried as to MilRoy's claims in any event. Therefore, since there is clearly a common nucleus of fact as to that claim under the pendent jurisdiction doctrine of Gibbs,

supra, the Court is satisfied that the Count may be maintained. The issue to be resolved is whether B & L may raise the issue, in light of its position as a licensee.

The standard in this District for determining whether a case or controversy exists in declaratory actions under the patent laws is whether the plaintiff or complainant has established a reasonable apprehension of an infringement claim. See Eastman Kodak v. Studiengesellschaft Kohle, 392 F.Supp. 1152 (D.Del. 1975). Under the circumstances of the present case, the Court is satisfied that a case or controversy as to Count I exists.

First it is clear in this Circuit that under the doctrine of Lear, Inc. v. Adkins, 395 U.S. 653 (1963), licensees need not repudiate or terminate their licenses prior to bringing suit. See American Sterilizer v. Sybron Corp., 526 F.2d 542 (3rd Cir. 1975). National attempts to distinguish this case on the grounds stated by this Court in Thiokol v. Burlington, 313 F.Supp.253; 319 F.Supp. 218 (D.Del. 1970), aff'd., 448 F.2d 1328 (3rd Cir. 1971), cert.denied, 404 U.S. 1019 (1972). That is, National asserts that while a suit may be brought by a licensee without termination, it is not a suit which is available to a licensee who is not accused of infringement and therefore cannot meet the test of the Declaratory Judgment Act, 28 U.S.C. § 2201.

It is not denied that B & L presently manufacture soft lenses, and that absent the license it would be an infringer if the patent is valid. It is also not denied that National and B & L are presently disputing the terms of their mutual agreement. The mere existence of the license relationship and the lack of direct accusation of infringement in this case is not enough for this Court to say that no case or controversy exists. It is clear that National intends to defend the patent, and that B & L has a reasonable apprehension of being accused of infringement. Moreover, as Lear, supra, made clear, B & L has a substantial economic stake in a determination of invalidity or non-infringement. The Court holds that the interest of B & L in continuing to manufacture the lenses without a license and the substantial and reasonable fear that if it cancelled the license, it would be sued on infringement establishes an actual controversy between the parties and is sufficient to establish the right to bring the declaratory action. See Eastman Kodak v. SGK, 392 F.Supp. 1156; Thiokol II, 319 F.Supp. at 221.

The motion to dismiss Count I of the counterclaim is therefore denied.

B. Count II.

In Count II B & L urges that several additional patents, which are included in the agreement between National and B & L, are also invalid or unenforceable. National again asserts that no case or controversy actually exists as between the parties, and that in any event, jurisdiction is not properly in this Court under the Thiokol decision. B & L asserts that the claims may be brought under 28 U.S.C. § 1338 and that in any event they are ancillary to the MilRoy claims.

The Court cannot hold that the patents not raised by MilRoy are properly before this Court, on an ancillary or pendent basis. There appears to be no common nucleus of fact. Nor is it clear that within the discretion available under the Gibbs doctrine they are so closely related to the other patents as to be ancillary. This is especially true in light of the recent Third Circuit decision, In re Frost Patent, ____F.2d____, (No. 75-1937 3rd Cir. July 14, 1976). The fraud not connected with the '858, '401, and '089 patents would not appear to be necessarily a part of the circumstances which would require or lead to a declaration that those patents were invalid. See In re Frost Patent, supra, slip opinion at 23.

Nonetheless, the Court is satisfied that jurisdiction as to Count II rests in this Court. As the Court has noted

above, the financial stake of B & L and its reasonable appre-hension of an infringement action as part of National's enforce-ment of its rights in the event it cancels the license provide a basis for it to seek a declaration of invalidity. The force and scope of the Declaratory Judgment action as a vehicle for the early determination of rights would be restricted unduly if it were held otherwise. Cf., Eastman Kodak v. SGK, 392 F.Supp. at 1158. And other important public policies would be ill served. See American Sterilizer v. Sybron Corp., 526 F.2d 542 (3rd Cir. 1975).

Nor does Thiokol block the application here. In light of the Amsco opinion, supra, it is clear that a licensee is entitled to sue in this Circuit without terminating the agree-ment. Since the allegations in the second count concern solely the claims of the patents and their validity, the action is one "arising under" the patent laws, and therefore is within 28 U.S.C. § 1338.

The Court will, however, in view of the Thiokol deci-sion, 448 F.2d 1328 (3rd Cir. 1971), stay any proceedings on Count II, since the patents at issue there are presently the subject of the action in the New York Supreme Court. As the Court reads the Third Circuit decision in Thiokol, the existence of concurrent jurisdiction in this Court and the state court gives rise to questions of comity, and the proper and efficient

use of judicial resources. 448 F.2d at 1332.[8] This Court will not act to interfere with the progress of the New York state litigation which has been pending for some three years, absent a determination by that court that it will voluntarily yield to this Court's determination of the patent issues. 448 F.2d at 1332.

B & L has urged that there is precedent in New York, for the courts of that State to yield patent questions to the federal courts. See Research Corp. v. Singer-General Precision Inc., 36 App.Div.2d 987, 320 N.Y.S.2d 818 (3d Div. 1971). The fact that such a precedent exists is insufficient. Federal and State comity requires federal courts to stay their hand where the issue may more appropriately be dealt with by the existing state court remedy. Cf., Huffman v. Pursue Ltd., 42 U.S. 592 (1975). See Thiokol, 448 F.2d 1332. Of course, B & L may request the New York Supreme Court to stay its determination, though as this Court has already made clear, it has full and complete confidence in the ability of state court judges to determine patent issues in accordance with the applicable law. See

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8 The jurisdiction provided by 28 U.S.C. § 1338 is exclusive as to suits arising under the patent laws. See note 7 supra. State courts may, however, determine patent issues which arise in the course of contract enforcement actions brought before them. See Lear, Inc. v. Adkins, 395 U.S. 653 (1969); Thiokol v. Burlington Ltd., supra, 313 F.Supp. at 256.

Thiokol II.[9]

The motion to dismiss Count II is denied.

C. Count III.

In Count III of its counterclaim, B & L attempts to assert the invalidity of the entire agreement or "package" which it has with National. Insofar as this Count asserts the invalidity of patents, it is subsumed by the decision of this Court supra, covering Counts I and II. Since the Count ought not to be read as a nullity, or mere duplicitous pleading, and because of certain types of relief which B & L seeks,[10] it would seem that the focus of this Count is not on the patents but on the enforceability of the agreement itself.

The Court is satisfied that Count III must be dismissed. It is clear that the agreement as such does not arise under the patent laws, and would present issues of state law proper only in diversity. See Thiokol, supra, 313 F.Supp. at 256. Federal patent questions included in the contract suit may be determined here, if the New York Supreme Court chooses to yield. Even in that event, the state court will retain the

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9 ". . .[P]laintiff intimates that defendants' real purpose in deferring from an infringement action and merely suing in state court for royalties is to attempt to obtain a ruling that the patent is valid from a state court inexperienced in federal patent law and awed by the Patent Office's grant of the patent in suit. This Court refuses to adhere to any such uncomplimentary view of the capability of the Pennsylvania State courts. . . ." 319 F. Supp. at 222-23 (fn. omitted).

10 See Answer and Counterclaim at 8-9.

questions of the enforcement of the contract, the only issues of the package not accepted by this Court under Counts I and II.

B & L urges strongly that the agreement presents a common nucleus of fact as to the patents. It does not. The allegations of the prior counts relate to National's patentee and to conduct before the Patent Office, e.g., whether the invention was anticipated in the prior art; or whether the patentee committed fraud on the Patent Office. Issues which relate to the contract or National's and B & L's conduct in the course of their agreement, do not affect the validity of the patents. Rather they relate to the enforcement of the contract inter se the parties.

The motion to dismiss Count III is granted.

Escrow

B & L has sought by motion here to place its next quarterly payment under the contract with National in escrow. Two separate, but interrelated grounds, are urged. Although the parties asserted that if Count III were dismissed, there would be no need to rule upon this question, it is clear that the Court must nonetheless make findings, since the motion was in part for an injunction to restrain termination of the agreement by National in the event of the payment being made in escrow or not at all.

B & L claims to be entitled to the return of such royalties as it pays following its allegation of the invalidity of the patent. See Zenith Laboratories, Inc. v. Carter-Wallace, Inc., 530 F.2d 508 (3rd Cir. 1976). B & L admits that it seeks by this route to have security for any recovery of royalties to which it might be entitled upon a finding of invalidity.

The Court does not see how this need for security differs from any asserted by a party for other prejudgment security. Strong showings of necessity must be made before the Court will order such security, assuming that Rule 64, Fed.R. Civ.Proc. does not apply. While it might well be within the power of the federal courts to grant such prejudgment relief, the Supreme Court has made clear that normally there is a great showing of hardship required. Compare De Beers Consolidated Mines v. United States, 325 U.S. 212 (1945), with United States v. First National City Bank, 379 U.S. 378 (1965).

Here, no such showing has been made. The affidavit in the case establishes the present solvency of the defendant National. Pollak affidavit, Docket Item 39, ¶ 13,14. The fact that the Czechoslovak Academy of Sciences is before this Court is sufficient to determine that if a judgment is rendered it will be obeyed. B & L has not shown otherwise, and disobedience to judgments will not be presumed. B & L has not

borne the burden necessary for the relief it seeks.

Moreover, insofar as the issues of escrow and cancellation relate to the entire package, they are properly before the New York State court and not this Court. B & L urges that Lear and its progeny establish a right on the part of licensee to be completely protected during pendency of the litigation. It is clear that under the case law, no one may require the licensee to pay royalties during the time when he attacks the validity of the patent. Zenith v. Carter-Wallace, supra, 530 F.2d 508 at 513. See Lear, 395 U.S. 653. The question of whether the contract may be cancelled if such royalties are withheld, however, is at least initially one of state law, and not federal policy. The New York Court stands open, and has already ruled on related issues. The licensee is fully protected insofar as the federal policy is concerned by his ability to choose. He may pay the royalties while attacking the patent, and upon proving invalidity, recover the amount paid since the allegation of invalidity. Zenith, supra. Or he may refuse to pay the royalties. Id. It is basic black letter law that an injunction requires a showing of both irreperable injury and lack of an adequate remedy at law. Neither irreperable injury nor lack of adequate remedy has been shown here.

The motion for an escrow or for an injunction to restrain cancellation or termination of the contract is denied.

Submit order.

Certificate of Service

I hereby state under penalty of perjury that two (2) copies of BRIEF FOR PLAINTIFFS-APPELLANTS and one (1) copy of APPENDIX TO THE BRIEFS was personally served by me on Fish & Neave Attorneys for Appellee, Allied Chemical Corporation, by delivery of said copies to the offices of Fish & Neave, 277 Park Avenue New York, New York 10017 this 22nd day of October, 1976 at 12:25 PM

Bernard Seidner

Bernard Seidner